HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Mr John Swinney MSP
Cabinet Secretary for Finance and Sustainable Growth
Scottish Government
St Andrews House
Regent Road
Edinburgh

October 2011

Dear John

SCOTTISH GOVERNMENT’S PAPER ‘DEVOLVING EXCISE DUTY’

I note with interest the publication of the Scottish Government’s paper ‘Devolving Excise Duty’ (October 2011).

As with previous papers published by the Scottish Government recommending additional powers, it leaves me with a number of unanswered questions, on which I would welcome your views.

Scope of Scottish Government proposal on alcohol duty

In particular, it appears that the recommendation made in the paper is quite different from previous statements made by Scottish Government ministers for devolution of excise duties. The paper instead appears to recommend assignment of alcohol duty revenues which would not raise the accountability of the Scottish Parliament in any way, a significant reversal from the Scottish Government’s
previous position. It would be helpful if you could confirm this and explain why you have altered your position.

Basis for assignment of revenue

It seems as though the proposal misrepresents how the Scottish budget is calculated. The paper appears to suggest that the Scottish Government receives a per capita share of all UK tax receipts, alcohol revenues included, and are therefore 'short-changed' because more alcohol receipts are attributable to Scotland than are received by the Scottish Government. You will be aware that this is not the way in which funding is allocated to the Devolved Administrations. Public services in the UK are funded by receipts from all UK taxes and borrowing undertaken by UK Ministers.

I therefore welcome your views on why would be appropriate to assign revenues from one particular tax to Scotland.

Hypothecation of alcohol duty

The paper seems to propose that excise revenues are hypothecated or 'ring-fenced' and used to mitigate the public health cost of higher alcohol consumption in Scotland. The concept of ring-fencing does not accord with how the UK tax system works. Alcohol revenues form part of general overall UK receipts. Further, were alcohol duty receipts to fall, it would leave a short-fall in the areas of public
spending which relied on these receipts. I would therefore welcome your views on this approach.

**Rationale for reducing block grant on per capita basis and allocating receipts on an expenditure basis**

I would welcome further explanation of your rationale for reducing the block grant by one figure and allocating revenues to Scotland based on another, particularly when this calculation appears to benefit the Scottish budget by £250m compared to a population based share of revenues.

I would also welcome further explanation of your methodology which appears to take 'tax paid in Scotland' based on expenditure as a proxy for consumption. Expenditure data is not necessarily the same as the consumption of alcohol and cannot be taken at face value, so I would be interested to know whether and how you have adjusted for the fact that prices vary by type of alcohol and across the UK.

I would welcome your views on why you think it is appropriate to allocate revenues from a production tax on the basis of consumption.

The proposed technique for calculating duties attributable to Scotland also causes me concern. I understand that Government Expenditure and Revenue Scotland uses the ONS survey Living costs and food survey to estimate alcohol consumption in Scotland, and extrapolates from this the amount of alcohol duty attributable to Scotland.
Although the survey is widely used, it has limitations. In particular, I would question the relatively small sample size as this would lead to some uncertainty in any calculation derived from it.

I would welcome your views on why this is therefore an appropriate basis on which to allocate millions in additional revenues to Scotland.

Creating conflicting incentives for the Scottish Government

Quite apart from this issue, allocating revenue on an expenditure basis and reducing the block grant on a per capita basis would create perverse incentives – the Scottish Government would stand to benefit financially from increased alcohol consumption in Scotland, running counter to the aim of reducing alcohol consumption and alcohol related harm. I would welcome your views on this.

Need for legislation

I would also welcome clarity as to why the Scottish Government is seeking to amend Scotland Bill in this regard. The proposal, as I understand it, would change the basis on which the Scottish Government was funded, but would not result in different tax rates or different duty regimes. As this is an administrative change, it would not need to be legislated for in the Scotland Bill. So I would welcome your views on why you consider it necessary to amend the Scotland Bill.
As you are aware, the UK Government has committed to considering the Scottish Government's proposals for further powers. In order to enable us to do this, I would be grateful if you could respond to these queries.

I would also like to draw to your attention the letter I sent on 5 September, which set out a series of questions on the Scottish Government's corporation tax proposals. I have yet to receive a response to these questions – without which, the corporation tax proposals as they stand do not provide enough evidence or information to justify devolving CT rates to Scotland.

I would, as ever, be happy to engage with the Scottish Government further on these issues.

Yours ever,

David Gauke MP